

## China's gas price policies and reform ideas

Ladies and Gentlemen,

Good afternoon. I am very pleased to have the opportunity to attend "The 3rd China-US Gas and Oil Industry Forum" and to discuss with you problems concerning the two industries. With increasing attention being paid to environmental protection and energy supply security in all countries, the global natural gas industry has developed rapidly. China has rich natural gas resources whose exploration and utilization have great significance to improving energy structure, environment quality and energy security. In the guidelines of the 10th five year plan, the Chinese government puts forward the strategic goal of emphasizing both oil and gas development. The construction and operation of the project of transmitting gas from west to east China, Sebei-Xining-Lanzhou pipeline, and Zhongxian-Wuhan pipeline will greatly promote the growth of the natural gas industry. Scientific and rational natural gas price policies will play a key role in developing China's natural gas industry. Next I am going to deliver my presentation entitled <<China's Natural Gas Price Policies and Reform Ideas>>.

### 1. China's current natural gas price management situation

The current natural gas prices including well head prices and pipeline transmission prices, are either formulated by the government or under government guidance.

At present, well head prices consist of two prices for gas sold according to plan and outside plan sales. The prices of gas sold according to plan is formulated by government--responsible departments under the State Council. These prices are divided into various categories such as feed stock for fertilizer plants, residential, commercial and other facilities. Prices of gas sales outside the plan are formulated under government guidance. Relevant State Council departments formulate the base price and fluctuation range, and buyers and sellers can negotiate for the specific price accordingly.

The prices of pipeline transmitted natural gas are formulated by the government--responsible departments of the State Council. The principle for formulating the prices is based on the following factors: cost compensation, reasonable profit, conducive to market sales, and user affordability.

2. With the continuous development of China's natural gas industry, we have explored and reformed the price policies for natural gas. In the 1970s and 1980s, China's natural gas output was quite low, and the prices were mainly formulated by the government. In the early 1990s, to encourage more production of natural gas so as to solve the contradiction between supply shortage and low prices, the "dual price" system was adopted for sales according to plan and outside plan. With the development of China's natural gas industry, and the formation of the natural gas market, it is urgently needed to deepen reform and to perfect the price-formulating mechanism of natural gas.

At present, the main problems in natural gas price management can be attributed to the lack of a scientific, rational, and flexible pricing mechanism.

1) The price management methods need to be standardized. With the decrease of sales within plan, the well head gas price based on the "dual price" system has led to price increases. Users of the same category pay different prices

depending on if the supply is within the plan or not. This is a violation of the principle of equal pay. At the same time, the collection of purification fee in addition to the price is not totally justified.

2) Currently, price is decided according to production cost. On the one hand, there is a lack of cost constraint for the enterprises that are not pressured or motivated to reduce cost. On the other hand, influenced by resource condition and other factors, the production and operating costs of the enterprises have gone up so much as to exceed the price.

3) The government-guided price formulating management lacks flexibility and the negotiating mechanism between supply and demand. The prices do not respond to the actual demand and supply situation in the market, thus fail to play the role of encouraging enterprise production and guiding consumption.

In deepening reform of the natural gas price formulating mechanism, we face the following main contradictions.

1) The high cost of gas exploration and transmission and the low user affordability have to a certain extent constrained the exploration and utilization of the natural gas market. China's gas output mainly consists of associated gas. The gas fields usually have complicated and difficult geological and ground conditions which have led to high upstream exploration cost. In the meantime, China's natural gas reserves are mainly concentrated in the northwest, southwest, and central regions which are far from the gas markets concentrated in the eastern and coastal areas with more developed economy. Long distance transmission between production and consumption locations also means high cost. Conditioned by the economic development level, the chemical industry is a main user of China's natural gas with fertilizer plants, which have low affordability, using 40% of the total consumption. Civil usage only accounts for 20% of the total consumption. Only a small portion of gas supply is used for power generation. The consumption structure of natural gas has constrained its price increases. The contradiction between the high exploration and transmission costs and low user affordability has become a key one in price reform.

2) The monopolized regional markets have constrained the competitive mechanism. Now natural gas exploration, production, transmission and sales in China are mainly conducted by three large state-owned companies-Petro China, SinoPec and China Offshore Oil Corp. These three companies divide their gas and oil exploration, production, and operation on a regional basis, and their business seldom overlap with each other. Due to the lack of competition, the market competitive mechanism is not brought into full play. This has led to the lack of innovation of the state-owned enterprises, and limited the use of new technology and financial input. It has also led to low service quality and lack of protection of consumer rights, thus impaired the development of the natural gas market.

3) Legislation on natural gas supervision has lagged behind. At present, China has no laws and regulations on natural gas as needed by the market economy. The lack of the legal system and guarantee has led to great uncertainty in government supervision and management of the natural gas industry. Also the lack of scientific price formulating rules for natural gas producer price and pipeline transmission price has cast doubts in the minds of overseas investors.

From the long term point of view, with the gradual opening of China's natural gas market, the formation of a competitive market structure and the national transmission pipeline network, the government-formulated price will transform to

competitive market price. Given the present lack of full market competitive mechanism, we plan to carry out the natural gas price reform in the following aspects.

1) Standardize price management. First, cancel the "dual price" system and implement a single price. Second, make the purification fee part of the price. Third, increase the price of well head gas so as to cover production cost. At the same time, transform the pricing model based on cost, and consider related alternative energy prices in formulating competitive natural gas price.

2) Formulate rational prices for different kinds of users.

3) Establish a flexible pricing mechanism. First, in areas with initial market competition, switch from government-formulated price to government guided price, and leave the enterprises with some independence in pricing to respond to market demand and supply changes. Second, gradually liberalize the price for big users of direct supply who have multiple gas suppliers or alternative energy resources. Their prices can be decided through negotiations between buyers and sellers.

Pipeline transmission is monopolized in nature, so for some time to come the transmission price will still be decided by the government. The Chinese government will draw up more scientific and standardized transmission pricing principles and methods; Encourage the enterprises to reduce investment and operation costs and ensure reasonable returns on the investment so as to promote pipeline construction and meet the growing domestic demand.

Actually, price reforms have already been carried out in formulating prices for the West-to-East Gas Transmission project. The gas prices of the project are calculated not just according to the traditional cost factors, but more importantly according to the principle of equivalent alternative energy resources. The affordability of various kinds of users in different regions are analyzed and calculated. Gas prices of the project are competitive and comparable with the prices of alternative energy resources in local markets. In the future, the government will adopt even more flexible regulating measures for the prices of the West-to-East Gas Transmission Project, give the enterprises more pricing independence, and provide more negotiation opportunities for buyers and sellers.

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